



**THE  
KROGER  
CO.  
ANNUAL  
REPORT  
1988**

*"It makes good sense for Kroger to encourage employees to give something back to the community. I am able to volunteer some of my time to help others in need, and our customers seem to appreciate the fact that the people they shop with really do care."*

Jim McGurk  
Kroger Store Manager  
and Shareowner

*James J. McGurk*

*This is a summary annual report of The Kroger Co. for 1988. It is intended to give readers an overview of the Company's financial results and business strategy. Detailed financial information will be included with the corporate proxy statement that will be mailed in early April to each Kroger shareowner.*

## **THE KROGER CO.**

*The Kroger Co. is concentrated in two primary retail businesses, supermarkets and convenience stores. Kroger's food processing units provide the supermarkets with a broad variety of private label products. The stores and processing facilities are serviced by Company-operated distribution centers and a Kroger truck fleet.*

### **Supermarkets**

Kroger operates 1,235 supermarkets in the United States under a variety of names, including *Kroger, King Soopers, City Market, Fry's, Dillon Food Stores, Circle Super, Gerbes* and *M&M Markets*.

### **Convenience Stores**

The Company operates 958 convenience stores. They are *Turkey Hill Minit Market* in Pennsylvania; *Tom Thumb* in Florida and Alabama; *Time Saver* in Louisiana; *Kwik Shop* in Kansas, Iowa, Nebraska, Oklahoma and Illinois; *Quik Stop* in California; *Loaf'N Jug* in Colorado, Oklahoma and New Mexico, and *Mini Mart* in Wyoming, Montana, Colorado, Nebraska and North and South Dakota.

### **ON THE COVER:**

*Jim McGurk has managed the Kroger Food Store in the Franklin Square Shopping Center in Frankfort, Ky., since 1972. He's also one of his community's leading citizens, involved in a variety of local activities, including the Franklin County United Way, which supports a number of area programs, such as the Sunshine Center for child care. Recognized by the Chamber of Commerce as its 1988 "Small Businessman of the Year," Jim McGurk typifies the spirit of community involvement of Kroger store managers and employees nationwide. As a public company, Kroger encourages the volunteer activity of people like Jim (for other examples, see pages 8-11) because we believe community service is a key component of total business strategy.*



## FINANCIAL HIGHLIGHTS

NOTE: These financial highlights should be read in conjunction with the audited financial statements that will be included with the proxy statement.

	1988 (52 weeks)	1987 (52 weeks)	1986 (53 weeks)
<b>Sales:</b>			
Continuing Units	\$ 17.5 billion	\$ 16.4 billion	\$ 16.2 billion
Increase over prior year	6.7%	1.2%	6.8%
Total Company	\$ 19.1 billion	\$ 17.7 billion	\$ 17.1 billion
Increase over prior year	7.9%	3.1%	7.2%
<b>Operating Cash Flow:</b> <sup>(a)</sup>			
Continuing Units	\$ 740 million	\$ 649 million	\$ 590 million
Total Company	\$ 756 million	\$ 648 million	\$ 592 million
<b>Interest Expense, Net</b>	\$197.6 million	\$ 95.8 million	\$ 91.0 million
<b>Net Earnings</b>	\$ 34.5 million <sup>(b)</sup>	\$ 246.6 million <sup>(c)</sup>	\$ 55.8 million <sup>(d)</sup>
<b>Earnings per Common Share</b>	\$ .24 <sup>(b)</sup>	\$2.99 <sup>(c)</sup>	\$0.60 <sup>(d)</sup>
<b>Dividends per Common Share</b>	\$49.513	\$1.050	\$1.025
<b>Capital Expenditures</b>	\$323.4 million	\$ 415.8 million	\$474.6 million
<b>Real Estate Data:</b>			
Food stores			
Opened and acquired	59	100	60
Total at year-end	1,235 <sup>(e)</sup>	1,317	1,272
Convenience stores			
Opened and acquired	82	160	104
Total at year-end	958	889	735

<sup>(a)</sup> Operating cash flow equals earnings before interest, depreciation, the restructuring charge, LIFO charge and taxes based on income.

<sup>(b)</sup> Includes charges of \$129.9 million, or \$1.64 a share, after-tax, for one-time expenses related to restructuring.

<sup>(c)</sup> Includes an after-tax credit of \$3.8 million, or five cents a share, for over-estimation of restructuring costs; and includes a one-time credit of \$63.3 million, or 79 cents a share, for a change in accounting for income taxes.

<sup>(d)</sup> Includes a special charge of \$82.3 million, or 95 cents a share, after-tax, for corporate restructuring and a \$10 million after-tax charge for the establishment of the corporate charitable foundation and excludes results of discontinued operations.

<sup>(e)</sup> Excludes 60 units divested or in the process of divestiture.

## TO OUR FELLOW SHAREOWNERS:

**A**mid the events surrounding Kroger's restructuring in 1988, your Company had an exceptionally good year. Stronger sales, reduced operating costs and improved service to customers contributed to positive results from every part of the organization.

Restructuring dramatically changed the financial structure of the Company. Yet throughout 1988, Kroger's basic business flourished. Customers received value, quality and convenience in our 1,235 supermarkets and 958 convenience stores. Innovative merchandising strategies

enabled Kroger to maintain a leading position in its markets. Our 160,000 employees provided superior service that satisfied customers and, in turn, strengthened Kroger's quality performance.

**T**otal sales on a continuing unit basis (that is, including only those operations still a part of the Company after the 1988 restructuring) were \$17.5 billion, an increase of 6.7% over 1987. Operating cash flow from these continuing units, which consists of pre-tax earnings before interest expense, LIFO, depreciation, plus restructuring and other charges, was \$740.1 million—13.9% ahead of the previous year. Cash flow is a key measure of Kroger's ability to repay the debt taken on as part of restructuring. As expected, the increased interest expense and other costs related to restructuring caused a decline in net income from 1987. Net income also was affected by a substantially higher LIFO charge, due to rising inflation in the cost of goods.

### The Effect of Restructuring

Sweeping changes in the nation's capital markets have brought about the consolidation and realignment of assets in much of the retail food industry over the past two years.

Kroger responded to this changing environment with a restructuring plan that retained the intrinsic value of the Company's extensive experience in food retailing. In addition, the plan rewarded shareowners with substantial *immediate* value, in the form of the special dividend paid last fall, plus the potential for *additional* appreciation through a continuing ownership stake in the Company.



**Joseph A. Pichler**  
*President & Chief Operating Officer*

**Lyle Everingham**  
*Chairman & Chief Executive Officer*



**K**roger enters its 106th year a stronger organization in several significant ways. The Company has a well-defined mission concentrated in supermarket and convenience store retailing. It is also leaner, with overhead costs sharply reduced and a decentralized management structure. Our stores are modern, competitive with the best of our retailing peers, and increasingly profitable.

Kroger's employee ownership has greatly expanded as a consequence of restructuring, and will soon constitute about 30% of the Company's outstanding shares. In addition, the increasing use of incentive pay programs and the active promotion of employee common stock ownership create a more forceful link between individual incentive and corporate business goals. This is a distinct "plus" in our service-oriented business.

Finally, Kroger's tradition of community involvement by employees, as portrayed in this summary report, remains a top corporate priority.

#### **The Immediate Challenge**

Kroger's overriding strategy for 1989 is simple: we must concentrate on the basics of retailing in a way that builds the business, improves cash flow and accelerates the repayment of the debt incurred in the restructuring. This requires well-run stores, stringent cost containment, creative merchandising, a demanding review of all assets and a spirit of teamwork among our employees.

**W**hen the restructuring plan was implemented last fall, operating cash flow was forecast to increase in 1989 by about 10% over 1988. We are hopeful this will turn out

to be a conservative estimate. The strong cash flow performance in 1988 was achieved even though the positive impact of cost reductions and the disposal of cash-draining assets was felt essentially only in the second half of the year.

With a strong base of stores, an aggressive business plan and costs held firmly in check, there is every reason to believe that 1989 will be a year of substantial progress. By continuing to respond to the needs of customers, share-owners, employees and communities, we are confident that Kroger will bring ample reward to those who have invested in the Company's vision.



**Lyle Everingham**  
*Chairman & Chief Executive Officer*



**Joseph A. Pichler**  
*President & Chief Operating Officer*

## BUSINESS REVIEW

Kroger's corporate restructuring has created a company focused on supermarket and convenience store retailing and concentrated in those markets where Kroger already enjoys a strong competitive position.

### Restructuring Review

On September 23, 1988, the Kroger Board of Directors approved a restructuring plan proposed by management. Under the plan, a special dividend of cash and debentures, worth a total of \$48.69 per share, was paid to all share-owners. Bank loans and subordinated debt totaling more than \$5 billion were arranged to finance the special dividend and for other corporate purposes. Underperforming operations and ventures outside the core business of supermarket and convenience store retailing were scheduled for divestiture, and administrative costs were sharply reduced.

The resulting company consists of 1,235 supermarkets and 958 convenience stores operating in 32 states. In addition, Kroger operates processing facilities which supply dairy, bakery and a variety of other private label food products to Company retail stores and to outside clients.

Stores and plants are serviced by a network of 20 company-operated distribution centers and a Kroger truck fleet.

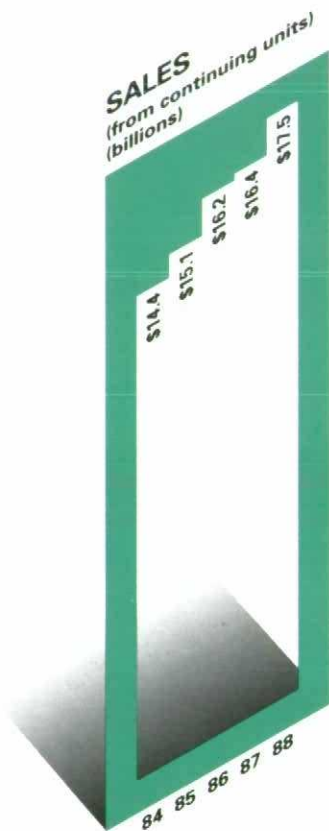
### Lines of Business

*Supermarkets*—Kroger's supermarkets account for nearly 90% of total Company sales. In 1988, the supermarkets continuing as part of the Company generated sales of \$15.9 billion, a 5.7% increase over 1987.

The most influential retailing-related event of the year was the severe summer drought in much of the nation's agricultural heartland. The drought raised raw material costs, which caused overall food inflation to nudge upward in the last three months of the year. Price increases were especially significant in grain-based products such as pasta, breakfast cereals and bakery items.

Competitive conditions were affected by the expansion of the superwarehouse and hypermarket formats in several Kroger markets. Despite the presence of these large-scale facilities, Kroger's supermarket formats continue to demonstrate broad customer appeal.

The Company generates the major share of its food store sales and profits from two formats. One is the





“superstore” facility, averaging approximately 30,600 square feet in size, which Kroger developed in the late 1970s and early 1980s. The other is the “combination” food and drug store, averaging about 50,300 square feet in size. Many of the combo stores have come onstream in the past five years. Profitability is enhanced by high margin specialty departments, such as floral shops, service meat counters, in-store delicatessens and bakeries and full-service pharmacies.

These new, state-of-the-art supermarkets, plus recently expanded or remodeled units, give Kroger store facilities that are among the most contemporary in the food retailing industry.

During 1988, strong performances were generated in virtually every major market served by the Company. Kroger divisions in the Southeast and Midwest all had exceptional results. Operations in Virginia and West Virginia showed renewed strength, as did the Houston market. In Colorado, *King Soopers* continued its rapid recovery from the work stoppage of 1987, while a solid operating performance helped boost results of *City Market*.

New labor agreements were reached in Columbus, Atlanta, Indianapolis and Memphis, further solidifying the

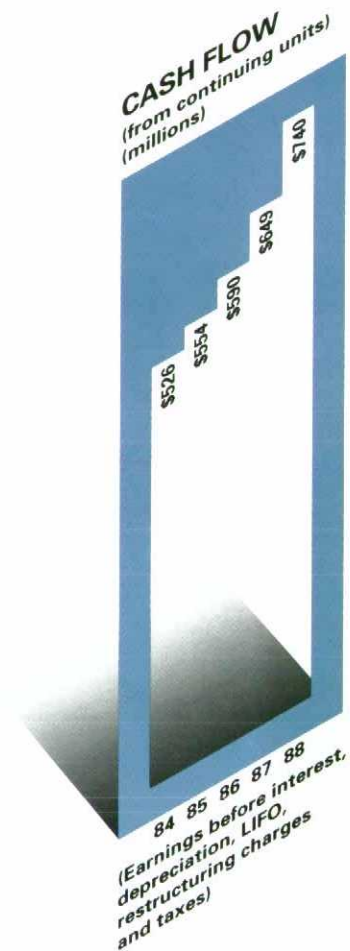
substantial progress the Company has achieved in labor negotiations in the decade of the 1980s. At the same time, Kroger broadened incentive pay programs to cover approximately 60% of the employee workforce. These plans typically provide bonus payments to hourly store employees based on the performance of their individual stores.

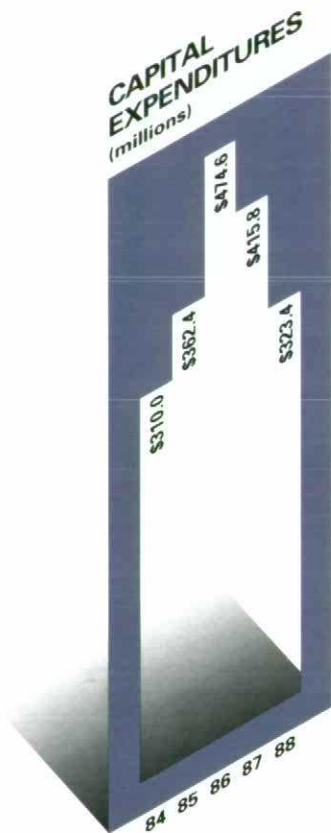
Kroger also initiated a five-year program designed to place the Company’s computer-driven management information system in the forefront of the supermarket industry. This plan should produce major productivity gains in an area of critical long-range importance.

*Convenience stores*—Consistently strong sales and earnings were achieved by the seven convenience store companies which, together, make up the nation’s fourth largest convenience store operation.

Sales reached \$698.4 million in 1988, while earnings also showed strong improvement. Results were favorably affected by substantially better gasoline margins and creative merchandising efforts, such as in-store fast food service.

*Food Processing*—Kroger’s food processing units continued to demonstrate their responsiveness to the changing lifestyles of our customers. Among the new private label products introduced in 1988 were the nation’s





first low-calorie cultured yogurt and oat bran bread, both of which enjoyed immediate success.

### Divestitures

The divestiture of assets announced as part of the restructuring plan is continuing, with proceeds better than anticipated. Kroger sold its supermarket operations in Florida, Charlotte, NC, Charleston, SC, and northern California. Additionally, Kroger terminated its *Welcome* superwarehouse venture and is in the process of spinning off its *Price Savers Membership Warehouse* subsidiary to a private investor group which includes current management. Kroger will retain a 40% ownership stake in *Price Savers*.

Early in 1989, Kroger announced its withdrawal from the Chattanooga, Tenn., market, consisting of seven supermarkets. The Company also has offered for sale 12 of the Company's 44 food processing units.

### Storing Plans

Between 1983 and 1987, Kroger invested nearly \$2 billion to build or expand 358 supermarkets, mostly combination stores. As a result, the Company possesses a substantial competitive edge against other operators, many of them also highly leveraged, who have not been as aggressive as Kroger in building new stores.

Over the next five years, the Company will continue its historical policy of annually renewing approximately 10% of its store base. For 1989, Kroger plans to spend about \$180 million for an estimated 140 new, remodeled or expanded supermarkets and 25 new convenience stores. In the years 1990-1994, the Company expects to build approximately 125 new stores, remodel about 460 existing stores and expand another 30 units, for an estimated total capital expenditure of \$800 million.

### Other Developments

In July, William J. Sinkula was promoted from Group Vice President to Senior Vice President, responsible for a number of corporate finance and capital management functions.

In January, 1989, Richard M. Koster, Executive Vice President in charge of Kroger merchandising and manufacturing, retired after 40 years of distinguished, creative service. He was replaced as Senior Vice President by Robert J. Hodge, a 22-year Kroger veteran who had been a Vice President of Kroger's wholly-owned subsidiary, Dillon Companies, Inc. Donald E. Dufek was promoted from Group Vice President to Senior Vice President, succeeding Walter F. Dryden, who retired after 36 years of exemplary service.



## Corporate Responsibility

The commitment of Kroger people to civic and charitable activities, at both the corporate and personal level, continued undiminished in 1988.

Perhaps the most widely publicized activity was "Round Up for the Hungry," implemented in Cincinnati in March. In this innovative program, customers voluntarily round up their grocery bills, with the extra cash used to provide perishable food items for the needy. Contributions from customers in Cincinnati alone totaled more than \$300,000 in the program's first year.

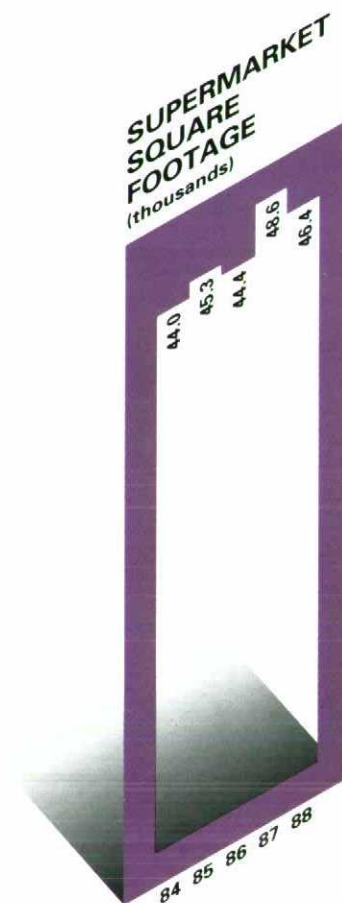
The pilot Round Up program was embraced by Kroger divisions in Springfield, Mo.; Nashville, Memphis, Detroit, Wichita, and all stores in Indiana, Texas and Illinois. Other retailers around the country have borrowed the idea and implemented their own Round Up programs, as well.

The program was a logical outgrowth of Kroger's longstanding commitment to combat domestic hunger. Through the volunteer efforts of Kroger employees, approximately one million pounds of food were donated to local food banks. The Company also maintained its

substantial support for Second Harvest, the national food bank organization.

At the local and store levels, Kroger employees were involved in a myriad of activities. Employee teams in Cincinnati-Dayton and in Lexington, Ky., won the Company's B.H. Kroger Employee Group Award for Community Service. An Atlanta store employee, Tom Holmes, received the individual B.H. Kroger Award for his volunteer work with rehabilitating substance abusers, while Ray Wilkes, a seafood clerk in Columbus, Oh., was similarly honored for his activities among the homeless and destitute.

The Kroger Charitable Foundation authorized more than 700 grants totaling some \$2.5 million. In addition, the various operating units of the Company made cash and product donations to a variety of local programs. The value of these donations exceeded \$500,000.



## KROGER AND COMMUNITY SERVICE

*Store managers within Kroger are the linchpin of the organization. They serve as the bridge between Kroger's merchandising strategies and the needs and expectations of consumers. A clean, fully-stocked store with friendly, efficient employees reflects the manager's competence and expresses Kroger's commitment to retailing excellence.*

*Managers traditionally have played another role: they've involved themselves in the broader community. That's why bake sales, canned food drives, health care screenings and dozens of other community activities have always found a home in Kroger.*

*Many managers become personally involved... like John Montoya (right).*

*John, 33, manages Loaf 'N Jug #34 in Pueblo, Colorado, and balances a busy work schedule with an unusual volunteer activity: playing his guitar in nursing homes and a neighborhood pre-school.*

*A self-taught musician, John says his music seems to soothe and comfort his audiences, young and old alike. "The kids' faces always light up and with the older folks, well, a lot of them are lonely. Making them smile is a big reward for me."*







*Kroger's charitable and community activities are an integral part of the business. There is a clear understanding throughout the organization that Kroger cannot serve the community unless it is successful in business, and it cannot be successful in business unless it serves the community...generously, effectively and visibly.*

*"I think managing a successful convenience store means knowing your customers as individuals. That way, you know their needs and you can find a way to give them something in return for their business."*

John Montoya  
Loaf 'N Jug Store Manager  
and Kroger shareowner

*John Montoya*

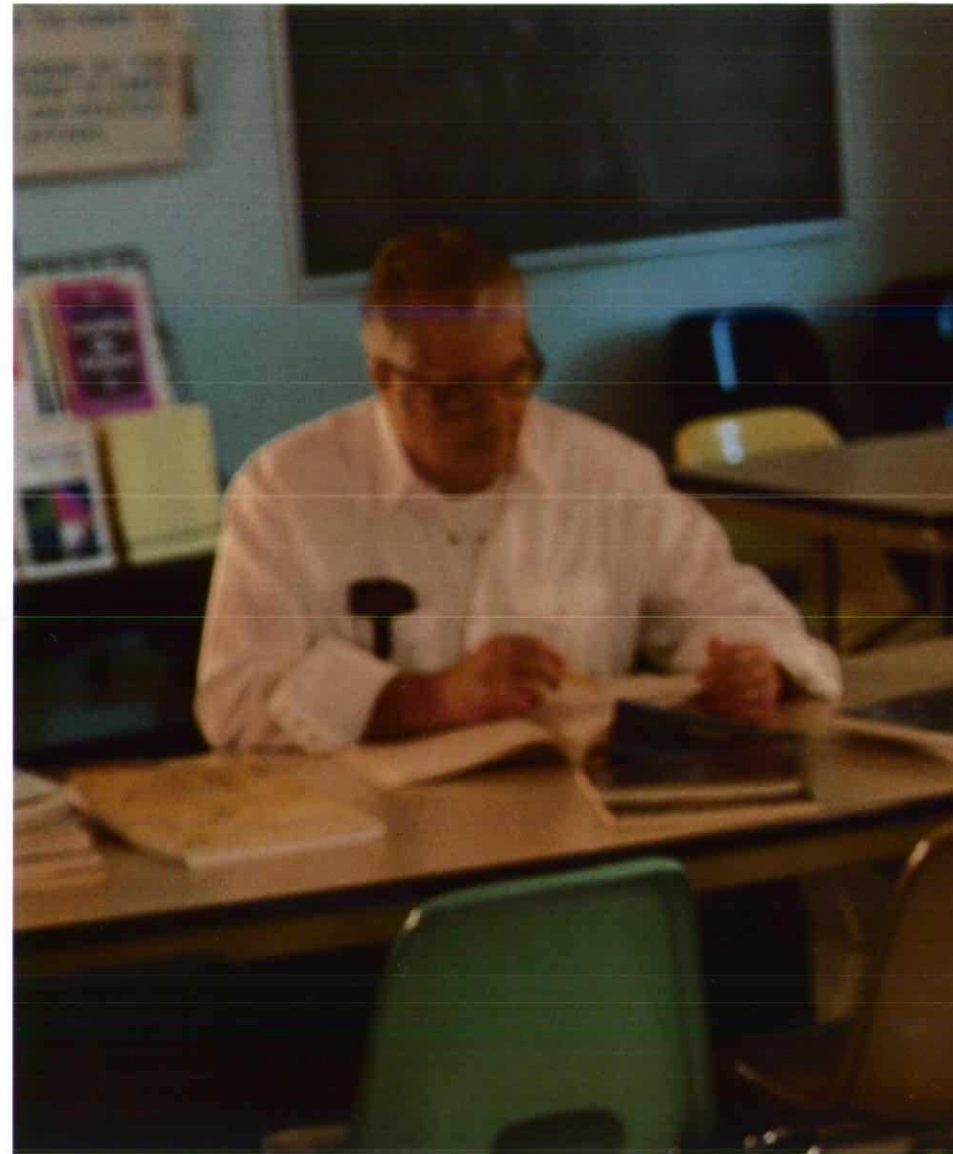
*Lisa Skelly manages the King Soopers supermarket in the Denver suburb of Lakewood, Colorado. A 14-year King Soopers employee, Lisa was promoted to store manager nine months ago.*

*"I'm never far from the store, even when I'm not working," she says. "To be a good store manager, you really have to live your job."*

*But despite a long work week, Lisa is a committed volunteer in her community, like thousands of other Kroger employees around the country.*

*Right now, she's a volunteer with Project Literacy U.S.A., and spends part of her off-duty hours tutoring reading and writing skills. "For most of us, reading and writing are so automatic, we never think about it," Lisa says. "But for some people, it's a struggle just to sign their name or read a newspaper. In a very real sense, they are closed off from the rest of the world."*

*Lisa thinks her volunteer work not only opens the world*







*for the people she helps tutor, it also has an important effect on the employees she manages. "In my position, I know that I am setting an example, not only at work, but in areas like volunteer activity. My store employees are aware of what I am doing, and I think it makes them more willing to become involved themselves. And it doesn't have to be anything big—just helping even one other individual is important."*

***"The commitment to community service by the King Soopers organization has helped me realize that business is able to contribute in a meaningful way to the overall well-being of the community, as well as individual customers."***

**Lisa Skelly  
King Soopers Store Manager  
and Kroger shareowner**

*Lisa*

*Skelly*

## CORPORATE OFFICERS

**David A. Burt**  
Senior Vice President

**David B. Dillon**  
President and  
Chief Executive Officer  
Dillon Companies, Inc.

**Ray E. Dillon, Jr.**  
Chairman of the Board  
Dillon Companies, Inc.

**Richard W. Dillon**  
Vice Chairman of the  
Board  
Dillon Companies, Inc.

**Donald E. Dufek**  
Senior Vice President

**Lyle Everingham**  
Chairman of the Board and  
Chief Executive Officer

**Robert J. Hodge**  
Senior Vice President

**Jack G. Hudson**  
Group Vice President

**Lorrence T. Kellar**  
Group Vice President

**George A. Leonard**  
Vice President and  
General Counsel

**Thomas E. Murphy**  
Group Vice President

**Joseph A. Pichler**  
President and  
Chief Operating Officer

**William J. Sinkula**  
Senior Vice President and Secretary

**Lawrence M. Turner**  
Vice President and Treasurer

## BOARD OF DIRECTORS

**William D. Atteberry**<sup>1,2,4</sup>  
Chairman of the Executive  
Committee and retired  
Chairman of the Board  
Eagle-Picher Industries, Inc.

**Raymond B. Carey, Jr.**<sup>1,6</sup>  
Chairman  
ADT Security Systems, Inc.

**John L. Clendenin**<sup>1,2</sup>  
Chairman of the Board and  
Chief Executive Officer  
BellSouth Corporation

**Ray E. Dillon, Jr.**<sup>5</sup>  
Chairman of the Board  
Dillon Companies, Inc.

**Richard W. Dillon**<sup>3</sup>  
Vice Chairman of the  
Board  
Dillon Companies, Inc.

**Lyle Everingham**<sup>4,5,6</sup>  
Chairman of the Board and  
Chief Executive Officer  
The Kroger Co.

**Jackson C. Hinds**<sup>2,5</sup>  
Former Chairman of the  
Board and  
Chief Executive Officer  
Entex, Inc.

**Dr. Patricia Shontz  
Longe**<sup>2,6</sup>  
Economist and  
Senior Partner  
The Longe Company

**T. Ballard Morton, Jr.**<sup>1,3,4</sup>  
Executive in Residence  
School of Business  
University of Louisville

**Thomas H. O'Leary**<sup>5,6</sup>  
President and  
Chief Executive Officer  
Burlington Resources, Inc.

**John D. Ong**<sup>3,5</sup>  
Chairman of the Board and  
Chief Executive Officer  
The BFGoodrich Company

**Joseph A. Pichler**<sup>3,4</sup>  
President and  
Chief Operating Officer  
The Kroger Co.

**Dr. W. George Pinnell**<sup>2,4,6</sup>  
Executive Vice President Emeritus  
Indiana University

**Otis M. Smith**<sup>1,3</sup>  
Of Counsel  
Lewis, White & Clay

Board Committees:  
(as of 1/1/89)

1 Audit  
2 Compensation  
3 Corporate Responsibility  
4 Executive  
5 Financial Policy  
6 Nominating



## KROGER STOCK OWNERSHIP PLANS

The Company has a variety of individualized plans designed to allow both employees and general shareowners to acquire stock in Kroger.

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**EMPLOYEES:** Kroger employees and employee benefit plans own shares through non-contributory ESOPs, pension plans and a profit sharing plan, as well as employee funded 401(k) plans and a payroll deduction plan, called the Kroger Stock Exchange. As of January 31, 1989, these plans in the aggregate owned approximately 18 million shares. It is anticipated that about 6 million additional shares will be purchased for the various plans during the first half of 1989 through the reinvestment of proceeds remaining from the restructuring special dividend. Once the purchases are completed, employees and the plans will own approximately 30% of the Company's common shares outstanding. Prior to the Company's restructuring, employee plans owned approximately 8% of Kroger's common shares. If employees have questions concerning their shares in the Kroger Stock Exchange, or if they wish to sell shares they have purchased through this plan, they should contact:

Star Bank, N.A. Cincinnati  
P.O. Box 1118  
Cincinnati, Ohio 45201  
In Cincinnati, call: 632-4397  
Toll Free 1-800-627-4397

Questions concerning any of the other plans should be directed to the employee's local Personnel Manager.

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**GENERAL SHAREOWNERS:** Individuals may make commission-free initial cash contributions to purchase Kroger shares through a special plan administered by Morgan Shareholder Services Trust Co. For information concerning this plan, or for questions concerning dividends, changes of address, etc., individual shareowners should contact:

Morgan Shareholder Services Trust Co.  
30 West Broadway  
New York, New York 10007-2192  
1-212-587-6515.

All shareowners who possess the 15½% Junior Subordinated Discount Debentures Due 2008 issued by the Company as part of the restructuring special dividend and who have questions concerning the debentures should contact:

Bankers Trust Company  
P.O. Box 9006, Church Street Station  
New York, New York 10249  
1-212-250-6000.

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General Information for all Shareowners:

*Form 10-K*—A copy of the Company's 1988 report to the Securities and Exchange Commission, Form 10-K, is available on request by writing: Lawrence M. Turner, Vice President and Treasurer, The Kroger Co., 1014 Vine St., Cincinnati, Ohio 45202-1119, or by calling 1-513-762-1220.

*Annual Meeting*—The Kroger annual shareowners meeting will be held at the Clarion Hotel in Cincinnati on May 18, 1989, at 10 a.m.

*Stock Trading*—The main trading market for The Kroger Co.'s common stock is the New York Stock Exchange, where it is listed under the symbol KR.

*Independent Certified Public Accountants*—Coopers & Lybrand, 1500 Atrium One, 201 East Fourth St., Cincinnati, Ohio 45202

*Shareowners*—At the end of 1988, a total of 60,964 shareowners of record owned 80,900,828 shares of Kroger's common stock.

BULK RATE  
U.S. POSTAGE  
PAID  
CINCINNATI, OHIO  
PERMIT NO. 8093



THE KROGER CO. • 1014 VINE STREET • CINCINNATI, OHIO 45201 • (513) 762-4000